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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 723

CHARLES T. FISHER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 89a-93a) are reported at 19 T. C. 384. The opinion of the Court of Appeals (R. 100a-104a) is reported at 209 F. 2d 513.

JURISDICTION

The judgment of the Court of Appeals was entered on February 3, 1954. (R. 99a.) The petition for a writ of certiorari was filed on April 26, 1954. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the Court of Appeals, affirming the Tax Court, correctly held that upon the sale of notes on which prior interest was in default the taxpayer received ordinary income rather than capital gain, to the extent that the amount paid him exceeded the principal obligation and was attributable to the past due interest.

STATUTE INVOLVED

The applicable provisions of the statute are printed in the Appendix, *infra*, pp. 10-11.

STATEMENT

As the Court of Appeals observed (R. 100a), there is no factual controversy here. The case was submitted upon a stipulation (R. 17a-48a), supplemented by uncontroverted evidence, accepted by the Tax Court in its findings. The relevant facts, as found by the Tax Court (R. 90a-91a) and as summarized by the Court of Appeals (R. 100a-101a), may be stated as follows:

On September 1, 1944, a Florida corporation was indebted to the taxpayer in the principal amount of $133,849.44, evidenced by its two year, six percent notes. On that date the taxpayer was entitled to receive unpaid interest on those notes in the amount of $75,574.29. (R. 90a.)

On September 1, 1944, the taxpayer was indebted to a personal holding company, Prime Securities Corporation, hereafter referred to as Prime, in the amount of $167,475, representing principal and in-

terest on his demand note held by that corporation. (R. 20a, 90a.)

The taxpayer offered to transfer the notes of the Florida corporation and his right to interest thereon to Prime for a consideration of $200,000. Prime was to apply his indebtedness to it in the amount of $167,475 in part payment of the $200,000 purchase price. Prime accepted the offer, cancelled the taxpayer's indebtedness to it as agreed, and paid the taxpayer the $32,525 balance of the purchase price in cash on September 1, 1944. Thereafter, during the years 1944 through 1950, Prime received full payment of the principal and interest owing on the Florida corporation's notes. (R. 90a.)

The above transactions were all bona fide. (R. 90a.)

In his income tax return for 1944, the taxpayer, who was on a cash basis, reported $66,150.56—the difference between the amount received from Prime and the total principal amount of the Florida corporation's notes—as a long-term capital gain. (R. 90a, 100a) The Tax Court held that this amount represented the proceeds from the sale of a right to ordinary income by the taxpayer and sustained the Commissioner's determination that it was therefore taxable as ordinary income under Section 22 (a) of the Internal Revenue Code. The Court of Appeals affirmed. (R. 90a-91a, 100a-101a, 104a.)

ARGUMENT

1. In holding that the taxpayer realized ordinary income rather than capital gain when he sold notes

on which interest was past due for an amount which exceeded the principal obligation and which was attributable to the interest then owing, the decision below correctly applies established principles. Under Section 22 (a) of the Internal Revenue Code (Appendix, *infra*, p. 10) interest is taxable at ordinary rates and is not a capital gain which is afforded preferential treatment under Code Section 117 (Appendix, *infra*, pp. 10-11). If the taxpayer, who was on the cash basis, had collected the interest in question from his obligor, he would have received ordinary income. The fact that he sold the notes to a third party, together with his claim to the past-due interest, receiving from the purchaser an amount far in excess of the principal obligation, is immaterial. The income which had already been earned, which would be taxed at ordinary rates when realized, retained its character even though the right to collect the income was sold to a third party. That the sale of the notes and of the claim for past-due interest was for a lump sum consideration did not alter the fact that the amount which the taxpayer received from the purchaser in excess of the principal obligation was attributable to the sale of the right to collect ordinary income.

Although there are no precise precedents for the decision below, it is controlled, as the Court of Appeals held (R. 101a), by general principles of income tax law. In *Watson* v. *Commissioner*, 345 U. S. 544, for example, there was a sale for a lump sum consideration of a citrus grove including an unmatured crop of oranges then on the trees. Re-

jecting arguments similar to those advanced by the taxpayer here, this Court held that, to the extent the purchase price reflected the value of the growing fruit, the vendor received ordinary income and that only the balance, representing proceeds from the sale of the grove property, was entitled to capital gain treatment. The *Watson* case illustrates the fundamental error in the taxpayer's contention that here the sale of the notes for a flat sum precludes the conclusion that part of the consideration was for the right to collect the past due interest which represented the receipt of ordinary income. See also *Kieselbach* v. *Commissioner*, 317 U. S. 399, holding that a lump sum condemnation award resulted in the realization of ordinary income to the extent that it included damages for delay in making payment.

Numerous other decisions support the basic proposition that ordinary income is realized when the right to collect ordinary income is transferred or sold. *Hort* v. *Commissioner*, 313 U. S. 28 (lump sum payment for cancellation of lease); *Rhodes' Estate* v. *Commissioner*, 131 F. 2d 50 (C. A. 6th) (sale of right to dividend after record date but before payment date); *Dixon* v. *United States*, 192 F. 2d 82 (C. A. 6th), affirming *per curiam* 96 F. Supp. 986 (E. D. Ky.), *Williams* v. *McGowan*, 70 F. Supp. 31, 34 (W. D. N. Y.), and *Trousdale* v. *Commissioner*, 16 T. C. 1056, pending on review in the Court of Appeals for the Ninth Circuit (sale of accounts receivable); *Helvering* v. *Smith*, 90 F. 2d 590 (C. A. 2d), and *Doyle* v. *Commissioner*, 102

F. 2d 86 (C. A. 4th) (sale of share in legal fees not yet collected). It is equally settled that an assignor of the right to receive ordinary income does not shift the identity of the taxpayer but remains taxable on the income. See e.g., *Helvering* v. *Horst*, 311 U. S. 112. By like token, one who sells the right to receive ordinary income already earned does not thereby alter the character of the income but remains taxable with the receipt of ordinary income.

There is no merit in the taxpayer's alternative argument (Pet. 16) (raised for the first time in this Court) that his 1944 tax liability is limited to the amount of interest paid in that year by the obligor to the purchaser of the notes. The taxpayer's liability is not affected by what the purchaser received or when he received it. The taxpayer's liability turns exclusively on the amount and the nature of the income which he himself actually received in 1944. He received, in addition to the principal obligation, the sum of $66,150.56. That amount, under elementary principles, is includible in the income for 1944 of this, a cash-basis taxpayer. *Austin* v. *Commissioner*, 161 F. 2d 666 (C. A. 6th), certiorari denied, 332 U. S. 767, on which the taxpayer relies, involved the liability of a gratuitous assignor and not, as here, the liability of one who sells and receives a cash consideration within the taxable year.

2. There is no conflict of decisions. *Commissioner* v. *Carman*, 189 F. 2d 363 (C. A. 2d), involved no issue concerning the character of gain

realized on the sale of obligations with past due interest. In the *Carman* case—as in *Shanis* v. *Commissioner*, 19 T. C. 641, also relied upon by the taxpayer (Pet. 8-9)—the taxpayers had purchased, at a flat price, certain defaulted corporate bonds with coupons attached. Later there was a corporate reorganization in which new securities were received in exchange. It was held that the entire exchange (including the new securities received for the interest accruing after the date of the taxpayers' acquisition of the defaulted bonds) was non-taxable under Code Section 112 (b)(3), and, more specifically, that (189 F. 2d 363, 364) "the bonds and their coupons were 'securities'" which were exchanged for new "securities" in a reorganization, so that a non-taxable event resulted under the express statutory language. No such specific statutory provisions, however, are applicable to the situation here to postpone the taxable event or to change the character of the gain. Actually, since the obligation in the instant case derived from interest bearing notes, the *Carman* decision would not have been applicable even in a corporate reorganization. See *Commissioner* v. *Sisto F. Corp.*, 139 F. 2d 253 (C. A. 2d). Indeed, it has long been the administrative practice, where the exchange is a taxable one, to tax as ordinary income the new securities which are received in satisfaction of the claim for the past-due interest on the old securities. I. T. 2896, XIV-1 Cum. Bull. 96 (1935).

The taxpayer asserts a further conflict with

Maass v. *Higgins*, 312 U. S. 443. (Pet. 10-12.) That case, however, involved the question of the valuation of securities for estate tax purposes where the executor elected to evaluate the estate as of a year after the date of death. It was held that rents, dividends, and interest received and accrued during the year, on which the estate was liable for income taxes, could not be added to the value of the gross estate and also subjected to estate tax. Despite the dissimilarity in issue and factual background, the taxpayer (Pet. 11) relies upon certain statements in the *Maass* opinion, taken out of context. As the Court of Appeals noted (R. 103a), the generalizations in the *Maass* case upon which the taxpayer relies "must be construed in the light of the problem then before the court." It found nothing in *Maass* to support the notion that a sale of income already earned, such as past-due interest, is not the realization of ordinary income. On the contrary, as the court below pointed out (R. 103a-104a) it was specifically observed in the *Maass* case (p. 447)—

> that, in common understanding, rents, interest, and dividends are income. Under the revenue acts, if such items are collected by a decedent's estate, the executors are bound to return them and pay tax upon them as income. In the case of a living holder, such receipts are never treated as on account of principal.

CONCLUSION

The decision of the court below is correct, there are no conflicting decisions, and further review is not warranted. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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MAY, 1954.

APPENDIX

INTERNAL REVENUE CODE:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 S. C. 1946 ed., Sec. 22.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) [As amended by Sec. 115 (b), Revenue Act of 1941, c. 412, 55 Stat. 687, and Sec. 151 (a), Revenue Act of 1942, c. 619, 56 Stat. 798.] *Definitions.*—As used in this chapter—

(1) *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property

held by the taxpayer primarily for sale to cusutomers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or about March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer;

* * * * *

(26 U. S. C. 1946 ed., Sec. 117.)

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